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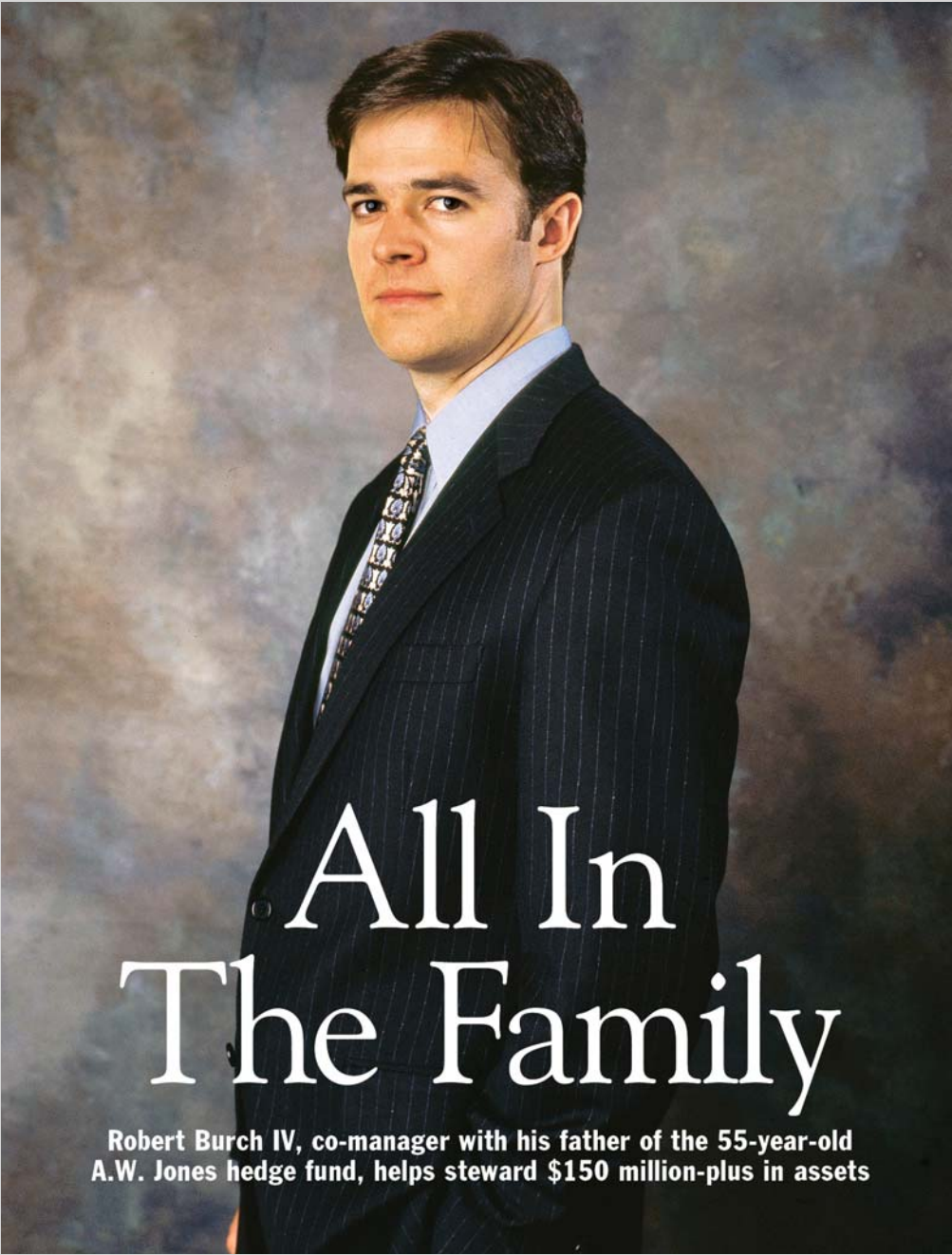
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BARRON'S

# Hedge Funds

A MONTHLY REPORT

INCLUDES FULL MUTUAL FUND LISTINGS



## All In The Family

Robert Burch IV, co-manager with his father of the 55-year-old A.W. Jones hedge fund, helps steward \$150 million-plus in assets

Patrick Harbron for Barron's

(over please)

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**DOWJONES**

# The Legacy

*A.W. Jones began the first hedge fund in 1949. His Burch progeny carry on.*

BY LAWRENCE C. STRAUSS

**I**N 1949 ALFRED WINSLOW JONES, whose background included a Ph.D. in sociology, a stint as a writer at Fortune but no time in the clubby world of Wall Street, launched an investment partnership.

“He was not a stock-market guy,” recalls Alex Porter, who worked for Jones in the late 1960s and early 1970s and went on to run hedge funds.

Largely self-taught when it came to the market, Jones was an astute observer and a quick study. With \$100,000 in seed money, \$40,000 of it from his own pocket, he nurtured the partnership, which operated in a way unusual for its day.

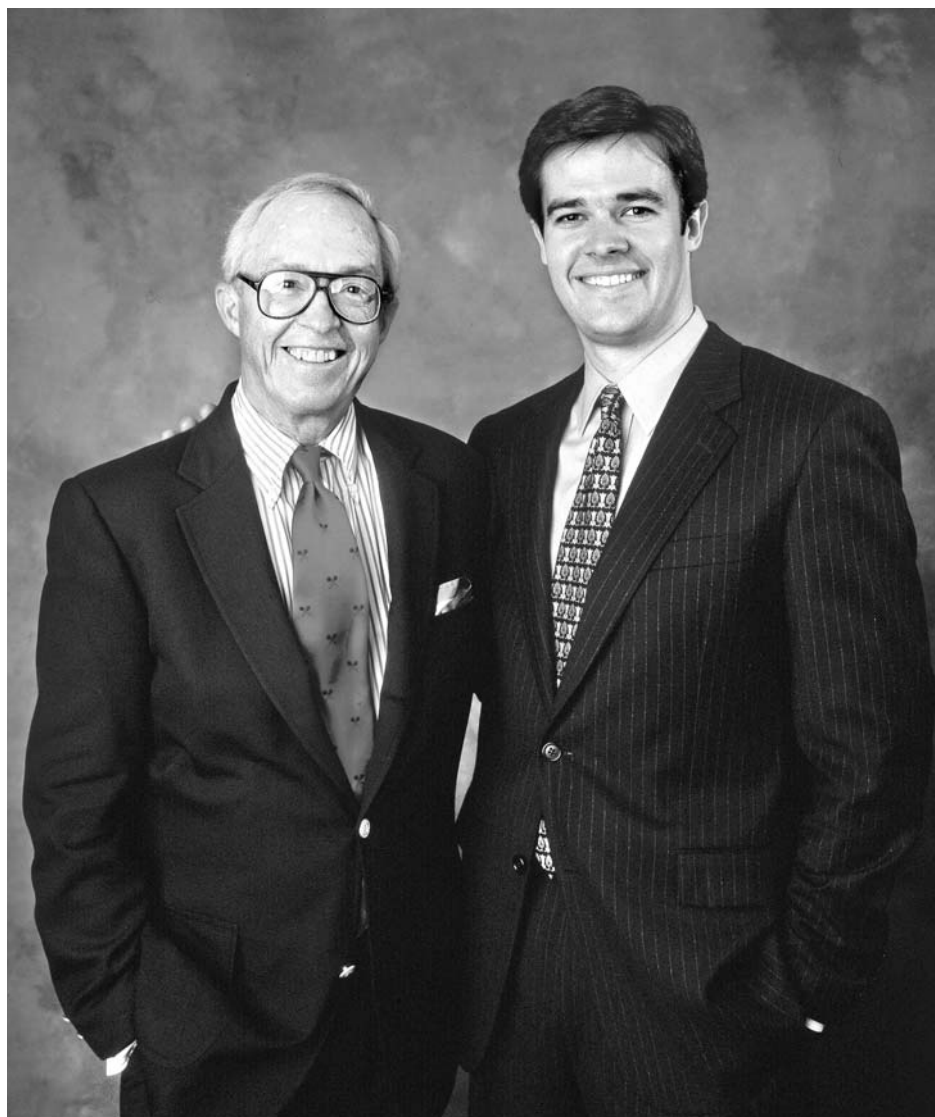
Jones, who ran the portfolio initially, borrowed money, increasing the amount he could invest. He also shorted stocks, although his long positions usually outnumbered the shorts. And the portfolio managers received 20% of annual profits. If the returns were negative, the managers didn’t get a fee that year. The fund invested entirely in stocks.

Nowadays, this kind of endeavor is widespread as the hedge-fund industry has exploded into a huge business with what some estimate is approaching \$1 trillion in assets. But when Jones kicked off his New York-based venture, named A.W. Jones & Co., 55 years ago, he was starting what is now widely viewed as the first hedge fund.

Of course, some would quibble with that assessment, noting, as Robert A. Jaeger does in his book *All About Hedge Funds*, that it’s likely investment partnerships prior to 1949 used hedge-fund strategies.

Nevertheless, Jones is regarded as a pioneer in the industry, particularly when you combine the hedging strategies with the performance-based compensation and the limited-partnership structure.

“It was an original design on his part,” says Charles D. Ellis, the financial writer and member of the board of advisers of Greenwich Associates. “It has become the way to do it.”



*Robert L. Burch III, left, with son Robert L. Burch IV, who run A.W. Jones. The hedge fund’s founder was the elder Burch’s father-in-law and the younger Burch’s grandfather.*

And unlike many hedge funds, which come and go as quickly as pop culture icons, A.W. Jones carries on to this day, run by Jones’ son-in-law, Robert L. Burch III, 70, Burch’s son, Robert L. Burch IV, 29, one of Jones’ grandsons. (Jones died in 1989.)

Ever since 1984, it has operated as a fund of funds through which the Burches select individual hedge funds into which to put their investors’ money.

Jones’ path to the hedge fund-world was circuitous. As a U.S. foreign-service officer in Berlin in the 1930s, he saw the

rise of Hitler first-hand. Later, he earned a doctorate from Columbia University, and his thesis was published as a book, entitled *Life, Liberty and Property*. In researching the project, Jones interviewed some 1,700 Akron, Ohio, residents “to gauge attitudes toward large corporations,” according to Amazon.com. Eradicating poverty was a subject to which he devoted considerable time through various philanthropic activities.

In the 1940s, Jones penned articles for *Fortune* on a variety of subjects, but he didn’t specialize in financial topics.

“His world was not a Wall Street world,” the elder Burch observes. “When he got into this business, he didn’t know a lot of people on Wall Street.”

In 1949, then working as a freelance, Jones wrote an article for *Fortune* titled “Fashions in Forecasting.” In researching that piece, he made some valuable contacts, learned a lot and decided that he should take a stab at money management.

Closing in on his 50th birthday, Jones started his hedge fund in January 1949, and he put up a big chunk of his own capital. “He doesn’t have a lot of money at this point,” Burch recalls, and a key concern was, “How do I maximize this money that I’ve got?”

“Risk aversion is at the top of the list,” he adds. “The question of maximizing returns with minimal risk is a very important question.”

Jones tried to generate performance through stock selection, long and short. But he adjusted his net exposure—that is, how many long stocks versus short positions—based on whether he and his colleagues thought the market was headed up or down and on their analysis of individual stocks.

“A hedge fund allows you, with longs and shorts, to stay in your longs through difficult times,” says Porter. “That’s the real genius of it....You’re able to stay long when the world is shaky. It’s not just that you’re hedging.”

During the first quarter of 1949, the portfolio was down 0.4%, including expenses, versus a 2.3% loss for the Dow Jones Industrial Average, according to a report by an outside accounting firm that reviewed the fund’s performance. There were 15 long positions, including



*Deceased founder A.W. Jones, above, created a stock-picking model his firm still follows.*

American Airlines and Caterpillar, and eight short positions, such as B.F. Goodrich.

As time went on, Jones ceded much of the day-to-day portfolio management to younger employees whom he mentored, provided they had the right stuff. To Jones, one of the toughest investment tests was shorting stocks effectively. “You have to have a different mind-set to go against the general thinking that everything is going to be

good,” says Jones’ son-in-law.

In an interview with *Fortune* in 1966, Jones said he was using “speculative techniques for conservative ends.” He believed that good short-sellers made for better stockpickers on the long side, as well. “He was looking for portfolio managers that could do both,” says the younger Burch. “The ones that could stay and got more capital.” That was his main management tool: allocating capital to portfolio managers who did well.

As the fund grew, Jones effectively ran an internal fund of funds, hiring promising young portfolio managers, many of whom went on to run their own funds, to handle pieces of the portfolio. Before bringing someone on board, the firm asked applicants to run a paper portfolio. Porter did that for about six months before joining the firm in 1967.

Jones did not levy a management fee. Instead he prorated management expenses to all of the partners based on how much capital they had invested. For many years, he worked out of modest offices in downtown Manhattan. Both his son-in-law and grandson maintain Jones would not support the hefty management fees of 1% to 2% hedge funds typically charged these days. “His belief was that managers should be paid only for performance,” says Robert Burch IV.

(The fund currently charges an annual fee of 0.40%, or 40 basis points, of assets if the fund increases its value during the year. On top of that, if the fund increases more than 16%, there is an additional 50-basis-point charge. In the world of today’s hedge-fund largesse, those fees are reasonable.)

Switching to a limited-partnership structure in the early 1950s enabled Jones to add more investors, many of whom weren’t especially wealthy, including friends from his days at Columbia. “It was not a big tool for super-rich people,” says Robert Burch III. “It was for his fellow intellectuals.”

Burch joined the firm in 1983 and became managing general partner the following year, when Jones was in his mid-1980s. A former investment banker at Kidder Peabody, Burch was running his own manufacturing business at the time, preventing him from taking a full-time role in the hedge fund. That’s when the partnership officially switched to a fund-of-funds approach.

Currently invested in 16 separate hedge funds and with more than \$150 million under management, the fund works with the Hennessee Group, a New York consulting firm, to analyze the performance of existing managers and to find new ones. “We both believe in spending money on research, not marketing,” says E. Lee Hennessee, managing principal at the Hennessee Group. “The research aspect is becoming more and more important as the industry continues to grow.”

Burch sums it up this way: “The key is getting the good managers and getting them early.”

The names they invest in include Viking, Maverick and Lone Pine.

The fund is closed to new investors. But the firm recently launched another fund. Clearly, the plan is for Robert Burch IV, a Princeton graduate with an MBA from Harvard, to guide the business, and the Jones methodology, well into the 21st century.

## FOCUS ON: A.W. Jones

**Investment Style:** Long-short equity  
**Specialty:** Sticking to one investing style over time  
**Website:** Awjones.com  
**Investment Theme:** Seeking above-average returns with below-average risk  
**How to Play It:** Invest in hedge funds hewing to the long-short equity style. That includes funds that use leverage

	Historical Total Returns*	
	A.W. Jones	S&P 500
5-Year**	5.30%	-0.57%
20-Year***	13.10%	13.21%
50-Year***	16.70%	11.48%

\*Annualized \*\*As of 12/31/03 \*\*\*As of 3/31/04

Sources: A.W. Jones; Ibbotson Associates

Looking at the returns is somewhat tricky, given the structure of the partnership and the rules that have governed it. Over the 50 years ended March 31 of this year, the fund averaged an annual total return of 16.7%, according to data provided by the Burches. That compares with 11.48% for the Standard & Poor's 500 Index over that period, according to Ibbotson Associates.

Over the past 20 years, the fund's compound annual return is 13.1%, 10 basis points behind the S&P 500. (Looking at the fund, whose underlying holdings include short positions, against the S&P, which is long only, is not an apples-to-apples comparison, but it provides some context.) The figures supplied by the Burches include all fees and expenses but

exclude things like internal reallocations between partners.

Burch and his son look for funds that hew to the Jones model, eschewing risk-arbitrage strategies and those that make macro bets on currencies. They typically replace two to four managers a year.

In Burch's view, the Jones model boils down to generating "above-average returns with below-average risk."

As to what he learned from his late father-in-law, Burch says, "Patience."

Burch notes that the portfolio has generated steady results over the past half century. As to what produced this consistency of results, he says: "I would argue it's Alfred's model. That hasn't changed. Everything else has changed. The Jones model, I would argue, works." ■